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CITY MANAGER

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TO: The Honorable City Council

FROM: L. Kimball Payne, III, City Manager 

SUBJECT: *Proposed FY 2006 Budget*

DATE: March 8, 2005

Introduction

The *Proposed FY 2006 Budget* for the City of Lynchburg includes the General, Schools, Capital, Airport, Water, Sewer, and Solid Waste Management Funds, as well as other minor funds and totals \$235 million. The proposed budget is characterized by higher revenues primarily as a result of the recordation of higher assessed values of real property in the City. For the most part the revenues are used to offset increasing costs for employee benefits, to provide additional funding for City Schools, to fully fund compensation decisions made during FY 2005, and to provide minimal salary increases. The fiscal realities facing the City do not allow for new initiatives or significant increases in funding beyond meeting minimal needs in any area.

Budget Development

In the abstract, budget development is guided by two principal sets of guidelines, the Financial Management Policies and priorities adopted by City Council.

Financial Management Policies

City Council first adopted Financial Management Policies in 1999 and has amended and reaffirmed them as appropriate. The policies address such areas as adopting a balanced budget, the appropriate fund balance to maintain, restrictions on its use for recurring operating expenses, debt management and the establishment of contingency reserves to address unexpected circumstances. If followed, sound financial management policies should do the following:

- Contribute significantly to the City's ability to insulate itself from fiscal crisis and economic disruption
- Enhance short-term and long-term financial credit ability by helping to achieve the highest credit and bond ratings possible
- Promote long-term financial stability by establishing clear and consistent guidelines
- Direct attention to the total financial picture of the City rather than single issue areas
- Promote the view of linking long-term financial planning with day to day operations
- Provide City Council and the citizens a framework for measuring the fiscal impact of government services against established fiscal parameters and guidelines



- Ensure that the organization is sufficiently resourced to perform mandated responsibilities
- Provide a foundation for evaluating financial analysis and condition

The Financial Management Policies are included in the General Budget Information section of the budget document. The proposed budget complies with adopted Financial Management Policies.

City Council's Priorities

City Council has identified and annually reviews priorities upon which City staff should focus resources. The priorities establish a baseline for City policy development and operations. Priorities identified by City Council include:

- A superior education community
- Stable, productive inspired families
- A dynamic economic development center with emphasis on downtown and increased real estate value
- A community environment second to none with emphasis on public safety and infrastructure
- Responsive, effective local government with emphasis on boards and commissions, fiscal responsibility, excellent core services, and fighting unfunded mandates

In addition to Council's priorities, there are a number operating principles important to the sound management of an organization that must meet mandated and contractual financial commitments while delivering quality services to the citizens of Lynchburg. Those principles include:

- Fund debt service
- Fund mandated programs
- Maintain a fund balance in accordance with fiscal policy
- Fund school construction at a level previously committed to by City Council
- Provide appropriate compensation for City employees
- Preserve employee benefits
- Replace essential equipment, especially vehicles and computers
- Maintain existing facilities
- Provide excellent core services
- Provide quality customer service

Limited resources prevent the proposed budget from going beyond these principles to address Council's priorities in significant ways.

Budget Preparation

City departments started preparing for the FY 2006 Budget in the Fall of 2004. The effort to move toward a biennial budget in the previous year provided a starting point for their work. At the same time, City Schools began budget preparation. Although the City was still anticipating increasing costs in a number of areas and only modest increases in revenues, the overall situation looked somewhat better than the previous year for three reasons. The first was steps that the General Assembly had taken in its 2004 session to address the structural deficit in the state budget. Projected shortfalls at the state level



threatened local funding in areas such as education, public safety, human services, and transportation. The tax increases adopted by the General Assembly and approved by the Governor, along with increasing state revenues as a result of economic recovery, reduced the pressures on local budgets in the upcoming year and will allow the state to better meet its commitments to support state programs administered by localities.

City Council had also made difficult choices in adopting the FY 2005 Budget, increasing taxes in several areas to address the City's own structural budget deficit. Increases in the Meals Tax, Motor Vehicle License fees, Ambulance fees, Personal Property Tax, and the Amusement Tax put the City in a better position to address increasing costs. This was the second thing that facilitated budget preparation.

The last reason that budget preparation looked less daunting than in the previous year was the reassessment of real property that was showing a degree of success in meeting a long-term goal of steady growth in property values in the City. The Assessor's Office is completing a four year effort to fundamentally rebuild the City's real property database and assessment system. That process corrected errors in past assessments and has accurately measured rising property values in several areas of the City, most notably in the commercial corridors, inner city neighborhoods and downtown. Increased assessed values provide additional resources to address City needs.

In addition to revenues from the Real Property Tax, other local revenues such as Sales Tax and the Meals Tax are increasing with the recovering economy. With additional state aid, overall revenues for FY 2006 were projected to show a modest increase from the current year. During budget preparation, no increases in tax rates or fees (other than Utilities) were anticipated.

Once anticipated revenues and combined expenditure requests were compiled, there was a gap of a little over \$10 million. General Fund expenditure requests of \$142.3 million compared to \$132.2 million in projected revenues. A number of cost increases or expenditure requests contributed to the gap between requested expenditures and anticipated revenues:

- \$428,000 increase in Virginia Retirement System (VRS) costs for City employees
- \$307,000 due to the anticipated expiration of the VRS life insurance premium holiday
- \$700,000 increase in health and dental coverage for City employees and retirees
- \$1.0 million cost for a 2% pay increase for City employees
- \$900,000 for firefighter pay increases previously approved by City Council
- \$900,000 for pay-as-you-go capital projects
- \$650,000 for requested new positions, salary adjustments, and related personnel costs
- \$260,000 for vehicle fleet replacements
- \$600,000 in additional debt service (General Fund & Schools)
- \$208,000 increase in payments for services under the Comprehensive Services Act (CSA)
- \$4.7 million in additional local funding requested for Schools to fund:
 - increased costs for health and dental coverage
 - increased costs of VRS
 - costs related to compliance with the Federal No Child Left Behind Act
 - a 5% pay increase for teachers
 - pay increases for other Schools employees
 - costs of textbook replacement



Budget Analysis

The *Proposed FY 2006 Budget* was developed using a modified zero-based process. The zero-based process requires each department to prepare a budget request that reflects the actual costs of performing its responsibilities as if it was being done for the first time. Merely proposing incremental additions to a previous year's budget is not acceptable. In a zero-based approach, the fact that a dollar was spent the year before is not relevant to a request for that same dollar in the new fiscal year. Each dollar must be justified as supporting the functions and operations of the department.

To facilitate budget review, volunteers from City staff, and two citizen volunteers served as budget analysts. The analysts were assigned particular departments to review and they met with department representatives, examined past spending patterns, questioned assumptions, and made recommendations to the City Manager. Line item details in the requested budgets were scrutinized in the process. Each line item was evaluated with respect to the need or requirement for the proposed expenditure, the anticipated value to be gained by the expenditure, and the reasonableness of the request based on prior years' history. After three years of zero-based budgeting there was little unjustified spending that could be identified.

Balancing the General Fund Budget

The process of balancing the budget required tough decisions after a serious consideration of requirements versus priorities and other wants. The expected growth in revenues was quickly eclipsed by increasing costs over which the City has little control. After that, there was little ability to satisfy requests for new or increased funding.

In balancing the *Proposed FY 2006 Budget* the following decisions were made:

Expenditure Adjustments

- The elimination of 7.33 existing vacant positions including an Accountant III, the EMS Office Supervisor, 2.33 Firefighters, 2.0 custodians in Buildings and Grounds, and a Financial Technician in Public Works Engineering (\$300,000)
- No funding of requests for seven (7) new police officers, three (3) communications specialists and various wage positions, including two (2) wildlife management specialists (\$464,000)
- No funding of requests for local salary supplements for Sheriff's deputies and the Registrar (\$130,000)
- Reduction of salary increase for General Fund personnel to 1% (\$500,000)
- Anticipated Managed Vacancy savings (\$841,276)
- Cost savings due to the continuance of the VRS Life Insurance premium (\$307,000)
- Reduction of the General Fund transfer to the Capital Fund (\$2.5 million)
- Reduction to the Schools request (\$2.7 million)
- Debt Service savings (\$225,000)
- A reduction of anticipated payments to the Blue Ridge Regional Jail (\$300,000)
- Not funding requests from local non-profit organizations (\$300,000)
- Reduction of funding of PC replacements in the General Fund (\$150,000)
- Reduction of fleet vehicle replacements (\$200,000)



- Reduction in Police/Animal Warden equipment: 4 vehicles, camera, evidence van, radios (\$194,000)

Altogether, these expenditure reductions total \$9.1 million.

Revenue Adjustments

The following adjustments were made to preliminary revenue estimates:

- Minor increases in Meals Tax, Sales Tax and the Tobacco Tax (\$350,000)
- Anticipated additional growth (8.5% v. 6%) in real estate assessed value (\$875,000)

The actions noted above, combined with various other minor adjustments in both expenditures and revenues, balanced the *Proposed FY 2006 Budget*.

The Budget Document

The budget document provides a complete description of the resources received by the City from all sources and their uses. All of the various funds utilized by the City are shown along with their proposed revenues and expenditures and balances.

Major categories within the General Fund are grouped substantially in accordance with guidance provided by the State Auditor of Public Accounts for comparative cost reporting. The budget document also includes organization charts for each department/division that show which positions are supported by local revenues and which are supported by other means such as federal or state aid or grants. Finally, under each General Fund department is a comparison of the request for FY 2006 to the amended adopted FY 2005 Budget and a listing of major items requested by the department but not recommended for funding.

Performance Measures

New to this year's budget document are performance measures. This initial effort is meant to demonstrate the City's commitment to results oriented government. The goal is to develop practical measures of the work done in the departments that promotes the City's mission of providing services in the most efficient, effective and equitable manner possible and improving the quality of life in Lynchburg. Just as overall financial performance is measured against the policy goals adopted by City Council in 1999, program performance can be measured against set objectives.

Each department was asked to include up to three performance measures that can be tracked over time and that will exhibit some measure of the efficiency and effectiveness of service delivery or demonstrate progress toward departmental goals. Samples of measures used by localities throughout the country were identified in the budget instructions for departments to consider or each department could develop their own measure(s).

The goals, objectives and measurements provided by each department in the budget are a first-step in an effort to provide City Council with measurements of the effectiveness of resource allocation. In subsequent years the measurements will be refined to focus more on outcomes that are meaningful to City



Council and citizens. As this effort evolves, at some point the City may want to benchmark its measures against those of other localities. *The Center for Performance Measurement* at the International City/County Management Association (ICMA) provides comparative data for over 100 localities of varying populations.

General Fund Revenues

Total General Fund revenues for FY 2006 are projected to be \$133.5 million, representing an increase of \$6.3 million or 5.0% above the *Adopted FY 2005 Budget*. General Fund revenues consist of both Dedicated Revenues (\$24.7 million) and Non-dedicated revenues (\$108.7 million).

Dedicated Revenues

Dedicated revenues are those revenues that are specifically designated by the Federal, State or City government to be used for specific programs and include federal and state categorical aid and grants, interfund transfers, charges for services and reimbursement for indirect costs from enterprise funds. Dedicated revenues in the *Proposed FY 2006 Budget* total \$24.7 million, an increase of approximately \$700,000 over the current year. Projections may have to be adjusted after finalization of the state budget.

Federal Categorical Aid is primarily funding for social services programs and totals \$5.6 million.

State Categorical Aid provides funding for Constitutional Officers, juvenile corrections, highway maintenance, social services programs and supports the public library. Funding is expected to total \$13.6 million, an increase of approximately \$800,000, due to additional support for highway maintenance and social services.

Interfund Transfers of approximately \$800,000 are related to reimbursements for various costs to the General Fund.

Miscellaneous Revenue totals approximately \$3 million and is comprised mostly of indirect cost allocations to the Solid Waste, Water, Sewer, Airport and Detention Home funds for services provided by General Fund departments.

Non-Dedicated Revenues

Non-dedicated revenues, or those revenues that can be used at the City's discretion, are projected to increase approximately \$5.5 million from the *Adopted FY 2005 Budget*.

Over eighty-five percent (85.6%) of non-dedicated revenues and nearly seventy percent (69.7%) of total General Fund revenues are generated by six local taxes, the Real Property Tax (\$40.4 million), the Personal Property Tax (\$17.8 million, including the state reimbursement), the Local Sales Tax (\$12.1 million), the Meals Tax (\$8.9 million), Consumer Utility Taxes (\$7.1 million) and the Business License Tax (\$6.7 million). With the exception of the real property tax, these revenue sources are especially sensitive to economic conditions.



General Property Taxes

Real Property Tax revenues are projected to total \$38.6 million, an increase of approximately \$3.0 million, or about eight and one half percent (8.5%) from the FY 2005 revised estimate. This is due to the capture of updated market values as a result of completion of the biennial reassessment and to some growth through new construction and rehabilitation. Real Property Tax revenue projections are adjusted for an historically uncollectible percentage of two percent (2%), tax relief for the elderly (\$516,000) and rehabilitation tax credits (\$209,000). For budget discussions, each penny on the Real Property Tax rate will generate approximately \$350,000. This revenue source represents over one-third (37.1%) of General Fund non-dedicated revenues.

The Assessor's Office is currently completing the biennial reassessment of real property which will take effect on July 1, 2005. Notices to property owners will go out March 1. At this point, it is projected that the total assessed value of real property in the City will increase eight and one-half percent (8.5%) to nearly three and one half billion dollars (\$3,471,288,000). Excluding new construction and corrections to assessment records, the total assessed value will grow by six and one half percent (6.5%). Adjusting the Real Property Tax rate to produce the same amount of revenue as during FY 2005 would require a reduction from \$1.11 to \$1.045 per hundred dollars of assessed value. Such a reduction, which is not recommended in this budget, would require an adjustment of approximately \$2.3 million to estimated revenues for FY 2006. Council will be required to hold a public hearing on the effective tax increase prior to budget adoption.

Personal Property Tax revenues are projected to decrease as a result of the lowering of vehicle resale values as determined by the National Automobile Dealers Association (NADA) which determines the values. Compared to the *Adopted FY 2005 Budget*, revenues are expected to be approximately \$400,000, or 2.2% lower in FY 2006. This loss of revenue was actually predicted shortly after the adoption of the *FY 2005 Budget* and will be experienced in the current year. Some growth of revenue (approximately \$100,000) is anticipated when compared to the revised FY 2005 estimate. The Personal Property Tax category totals \$17.5 million and represents nearly sixteen percent (16.1%) of General Fund non-dedicated revenues in the proposed budget.

Public Service Corporations Tax revenue is projected to increase about \$14,000 or less than one percent from \$2.510 million to \$2.524 million. This revenue is assessed by the State.

Other Local Taxes

Local Sales Tax revenue is the third largest portion of non-dedicated revenues to the City, representing eleven percent (11.1%) of those funds. This revenue source reflects the volatility of the economy and appears to reflect a strengthening in consumer spending. Projections indicate an increase of approximately \$600,000 from the *Adopted FY 2005 Budget*, to \$12.1 million.

Consumer Utility Tax revenues are projected to increase by approximately \$300,000 from FY 2005, to \$7.1 million.

Meals Tax revenues continue to grow. The revenue estimate of \$8.9 million represents over eight percent (8.2%) of General Fund non-dedicated revenues. Revenue growth of \$500,000, or 6.0%, is projected for FY 2006.



Business License Tax revenues of \$6.7 million reflect an increase of \$600,000 or ten percent (10.0%) from the current year reflecting the recovering economy. This source makes up about six percent (6.2%) of General Fund non-dedicated revenues.

Motor Vehicle License revenues are projected to remain stable at approximately \$1.55 million.

Amusement Tax revenues are projected to remain at \$392,000.

Other revenues in this category make up approximately \$4.7 million of the FY 2006 revenue stream. This category includes **Right of Way Fees** (\$320,000), **Cable Franchise License Fees** (\$550,000), **Electricity and Gas Consumption Taxes** (\$345,000), **Bank Stock Taxes** (\$585,000), **Recordation Taxes** (\$400,000), **Tobacco Taxes** (\$1.0 million), and the **Transient Occupancy and Lodging Tax** (\$1.5 million).

Permits, Fees, and Licenses (\$802,000), **Fines and Forfeitures** (\$540,000) are projected to remain stable in FY 2006, and **Revenue from the Use of Money and Property** (\$934,000) is projected to decrease about \$94,000 due to a reduction in interest on investments.

Charges for Services are projected to generate \$2.2 million.

Non-Categorical State Aid is projected to increase approximately \$300,000 due to an increase in State reimbursement for personal property tax. This category totals \$10.1 million and includes a number of sources. The largest is the state reimbursement for the Personal Property Tax Relief Act (\$6.5 million). Also of significance is funding under the provisions of House Bill 599 which is increasing about \$200,000 to \$2.8 million.

Miscellaneous revenues are projected to be approximately \$200,000.

General Fund Expenditures

Proposed General Fund expenditures of \$134.4 million represent an increase of \$8.6 million or 6.8% over the *Adopted FY 2005 Budget*. The difference between \$134.4 million in revenues compared to \$133.5 million in revenues is explained by the use of cash reserves for one time purposes. The General Fund finances all government activities with the exception of the Airport, Solid Waste Management, Water, and Sewer utility operations. All major funds contribute to the operations of the Fleet Internal Services Fund. A comparison of each of the General Fund operating departments as a percentage of total General Fund expenditures demonstrates the impact of these service areas on the entire proposed spending plan.

**Expenditures as a Percent of Total General Fund Expenditures****Proposed FY 2006**

	<u>General Fund Expenditures</u>	<u>Percent of General Fund</u>
General Government	\$10,934,575	8.0%
Judicial Administration	\$3,691,179	2.7%
Public Safety	\$27,524,405	20.2%
Public Works	\$14,211,690	10.4%
Health and Welfare	\$14,081,597	10.3%
Parks Recreation and Cultural	\$4,473,532	3.3%
Community Planning and Development	\$2,139,245	1.6%
Civic, Community and Regional Organizational	\$6,049,955	4.4%
Non-Departmental	\$3,826,447	2.8%
Schools	\$31,029,814	22.7%
Transfers	\$3,438,963	2.5%
Transfer to City Capital	\$2,161,978	1.6%
Reserves	\$1,450,000	1.1%
Debt Service	\$11,582,274	8.5%
TOTAL GENERAL FUND	\$136,595,654	100.0%

General Government includes the Council/Manager Offices, the City Attorney, the City Assessor, the Commissioner of the Revenue, Communications & Marketing, Financial Services, Human Resources, Information Technology, Internal Audit, the Electoral Board, the Registrar and the Treasurer. **Judicial Administration** includes the Circuit, District and Juvenile and Domestic Relations Courts, the Clerk of the Circuit Court, the Commonwealth's Attorney, the Magistrates Office, the Sheriff and the Court Services Unit. **Public Safety** includes the Police Department, the Fire and EMS Department, the Animal Warden, and Emergency Communications. **Public Works** includes Administration, Engineering, the Geographic Information System (GIS), Buildings and Grounds, Snow and Ice Removal and Streets. **Health and Welfare** includes Human Services Administration, Social Services, and Juvenile Services. **Parks, Recreation and Cultural** includes Parks and Recreation, the Library, and the Museum system. **Community Planning and Development** includes Planning, Neighborhood Services, Inspections, and Economic Development.

Civic, Community, and Regional Organizations are groups that provide services to the City outside of general government activities. Some activities, such as the regional jail, are mandated. The City has contractual relationships with other agencies. Funding of some organizations is discretionary. Some of the organizations historically funded in this area are non-profits that provide services through volunteers, private donations and grants along with a supplement from the City. The services that they provide are typically not provided by local government but may impact local government services indirectly. While City Council has agreed to consider funding for non-profits, budget constraints prevent a positive recommendation. Council may want to consider using one-time revenues to provide single-year grant assistance to these agencies.



Non-departmental includes those miscellaneous components of the City budget that generally do not fit nicely into an individual departmental budget but are widespread throughout, such as medical and dental costs and a general salary increase if programmed. **Transfers** include payments from the General Fund to other funds as a subsidy or payment for services. The most significant transfer is for City Schools.

Local Contribution to City Schools

Funding in an amount of \$36.5 million is proposed for school operations (\$31.0 million) and debt service (\$5.5 million). This represents a \$2 million, or 6.9%, increase in local funding for school operations, just covering the additional costs of maintaining current programs. With a projected decline in enrollment of 205 students, local per student support will increase from \$3,375 to \$3,696 or 9.5%. Total appropriations for Schools, including all activities and funding sources, will total \$80.1 million.

Significant Expenditure Increases

Significant changes from the current year in the proposed General Fund budget include the following:

- Funding to cover the increase in VRS retirement (\$428,000)
- Funding to support the annual cost of salary increases provided to Fire Department employees effective in January 2005 (\$900,000)
- Funding to complete the implementation of the Master Firefighter Program and Certification Pay in the Fire Department (\$214,000)
- Funding to cover an anticipated fifteen percent (15%) increase in active and retired employee health and dental coverage (\$700,000)
- Funding for a 1% general salary increase (\$500,000)
- An increased transfer to Schools of \$2.0 million to cover increased benefits costs and other needs
- An increase in City and Schools Debt Service (\$600,000)
- Funding for targeted salary adjustments and reclassifications for greater market equity (\$138,000)
- Additional costs of services under the Comprehensive Services Act (CSA) (\$320,000)
- GIS contractual services, hardware and software (\$209,000)

In addition to the recurring expenditures notes above, one-time funds were used for the following purposes:

- To increase the General Fund Reserve for Contingencies to the amount set by policy (\$400,000)
- Increased transfer to the Capital Fund (\$536,000)
- Increase funding for fleet replacement (\$260,000)
- Pay for performance initiative (\$507,000)



New Initiatives

Given the fiscal challenges facing the City, the *Proposed FY 2006 Budget* cannot support any new initiatives.

Debt Service

The City finances a large component of the Capital Improvement Program (CIP) with general obligation bonds. Schools debt service is increasing from \$5.4 million to \$5.5 million and City debt service is increasing from \$5.5 million to \$6.0 million for a total increase in debt service costs of \$0.6 million.

The FY 2006-2010 CIP anticipates the issuance during FY 2006 of \$16.8 million in bonds for capital projects. The largest of those projects will be the continued renovations to E.C. Glass High School, a project that is entering the last year of a three year construction program estimated to cost over \$27 million.

City Council's Debt Management Policy requires annual debt service expenditures for tax-supported debt to not exceed 10% of total General Fund expenditures plus transfers to the School Operating Fund and Reserve Allocations. FY 2006 debt service as a percent of operating expenditures is projected at nearly nine percent (8.6%).

Reserves

The *Proposed FY 2006 Budget* includes the following reserves:

Reserve for Snow, Streets and Bridges	\$250,000
General Fund Reserve for Contingencies	\$1.2 million
Reserve for Court Facilities	\$64,819
Reserve for Health Insurance	\$195,000

The proposed budget eliminates the Reserve for Economic Development that has been set aside in previous years. Instead it is recommended that the same amount of funds, \$200,000, be transferred to the Lynchburg Industrial Development Authority (LIDA) for it to maintain in its accounts and use for appropriate economic development activities supporting business recruitment, retention and expansion.

The Reserve for Snow, Streets and Bridges serves as a contingency should the costs of snow removal exceed budgeted resources. It is funded by the dedication of General Fund revenues. Unused funds are subsequently transferred to the Capital Fund for pay-as-you-go financing of street and bridge projects.

The General Fund Reserve for Contingencies funds expenditures during the fiscal year that were unanticipated during budget development. Any funds remaining in this reserve at the end of the fiscal year revert to the General Fund Balance. The Financial Management Policies establish a goal of \$1.2 million for this reserve. The *Proposed FY 2006 Budget* meets this goal through a combination of recurring and one-time revenues (\$800,000 and \$400,000 respectively).



The Reserve for Court Facilities is funded through the collection of Criminal Court Fines. The State gives localities authority to collect a small fee for each case to be dedicated to court improvements. It is anticipated that these funds will be used for the renovation of the Juvenile and Domestic Relations Court capital project. An amount of \$160,000 from this reserve is being used to fund design of the Juvenile and Domestic Relations Court project in the Capital Improvement Program.

A Reserve for Health Insurance was funded in FY 2003 and FY 2004 to be used in the event that health insurance claims exceeded budgeted funds. The amount listed above represents the funds remaining in that reserve. This reserve is approximately \$200,000 less than in the previous year due to the use of the reserve to cover high costs.

Fund Balance

City Council's Financial Management Policy requires an Undesignated Fund Balance equal to 7% of General Fund revenues with a targeted goal equal to 10% of General Fund revenues. In the event that the Undesignated General Fund Balance is used to provide for temporary funding of unforeseen emergency needs, the policy requires that the City restore the fund balance to the minimum of 7% within two fiscal years. If the Undesignated General Fund Balance falls below the target of 10%, the policy requires that it shall be restored to the 10% target within five fiscal years. The proposed budget provides for a 9.9% fund balance, amounting to \$13.2 million. It recommends utilizing \$2.2 million in fund balance for pay-as-you-go capital outlay.

The *Proposed FY 2006 Budget* complies with the financial management policy of matching ongoing expenditures with annual revenues. Utilizing fund balance to cover recurring costs is inconsistent with the financial management policies and would require actions to either increase revenues or reduce recurring expenditures in subsequent years.

Personnel

As with any service organization, the largest part of the City's operating budget, just over 75%, is devoted to employee compensation through salaries, wages and benefits. City Council understands the value of competitive employee compensation in recruiting and retaining a qualified, competent and diverse workforce capable of maintaining excellent core services. In furtherance of that goal, in November 2003, City Council adopted a *Compensation Philosophy* that articulates the principles under which the City's compensation plan will be managed. The City continues efforts to promote workforce stability and has experienced acceptable voluntary turnover rates and positive recruiting experience for most vacant positions.

The foundation of the City's compensation plan rests on the goal of attracting and retaining employees that are qualified, competent and representative of the community through pay ranges with minimums and benefits levels that are competitive with the relevant labor market. Using the Compensation Philosophy principles that guide periodic review of the pay plan, the Human Resources Department most recently measured market competitiveness in January 2005. That review indicated that, on average, the current pay range minimums lag the market by less than three percent (3%) and average actual pay is approximately eight percent (8%) below the market average actual pay. The proposed budget includes \$138,000 to fund pay range and salary adjustments for positions where the annual market survey indicated an adjustment to pay range minimum was justified. It also supports the on-going



reduction of job classifications through the pay banding of financial services positions and skills-related pay increases for mid-level Public Works Associates. Resources to provide a reasonable salary increase were not available. However, the proposed budget includes a one percent (1%) general increase and sets aside \$507,000 in one time funds to start a performance based pay initiative.

The City continues to experience rising health coverage costs due to increasing membership and industry-wide increases in prescription drugs, medical and dental services. Increasingly, high cost claims are driving the overall cost of medical coverage as new, life-saving, albeit very expensive, medications and treatments become available to covered employees. It is projected that a fifteen percent (15%) increase in medical and dental coverage funding for active employees will be required at a cost of \$350,000. Funding for the increase is included in the *Proposed FY 2006 Budget* without making plan changes or shifting costs to employees as was done in the past. The enterprise funds will also see proportional increases. In addition, costs for retiree medical and dental coverage are expected to rise approximately \$350,000. The City will continue to maintain a modest Health Insurance Reserve to buffer unexpected costs.

Fifteen (15) new full-time positions were requested by General Fund departments: seven (7) new police officers, five (5) for patrol and two (2) to address white collar crime, three (3) communications specialists, an environmental inspector, a construction coordinator in the Parks & Recreation Department, conversion of one (1) wage position in Procurement to full-time classified, and two (2) VIEW positions in Human Services. The proposed budget recommends funding only the environmental inspector (to meet state mandates), the construction coordinator (to be funded with capital funds) and the VIEW positions (with federal and state reimbursements).

The proposed budget includes the elimination of 7.33 vacant positions including an Accountant III in Financial Services, 3.33 positions in the Fire and EMS Department (EMS Billing Supervisor and 2.33 Firefighter recruits), a Financial Technician in Public Works Engineering, and 2.0 Custodians in Public Works Buildings and Grounds. This continues efforts to reduce the workforce through attrition that was started last year. Overall, twelve (12) positions have been eliminated since June 30, 2004 in the General Fund.

The General Fund workforce supported by the *Proposed FY 2006 Budget* would total 1044.10 Full Time Equivalent (FTE) employees, composed of 917.05 full-time classified, 38.4 part-time classified, 24.4 grant full-time, 0.75 grant part-time, and 63.50 state positions. The City's workforce in all funds totals 1,309.32 FTE's. This includes 1,142.87 full-time classified, 42.65 part-time classified, 59.55 grant full-time, 0.75 grant part-time, and 63.50 state positions.

Fleet Services Fund

The Fleet Services Fund is an internal services fund that manages the City's fleet of over 600 vehicles and equipment. The Fleet Services Manager reports to a Board of Directors consisting of representatives from various departments that utilize fleet services. The total operating budget of \$4.2 million for Fleet Services increased approximately one and one-half percent (1.6%) from FY 2005, primarily as a result of projected increases in fuel.



Annually, Fleet Services, in consultation with each department, determines the most efficient fleet replacement program for the next year based on actual miles driven and maintenance costs. A General Fund transfer of approximately \$1.1 million is provided for fleet replacement in FY 2006. This represents an increase of \$260,000 from the *Adopted FY 2005 Budget*. Due to fiscal constraints, an equipment depreciation component has not been factored into the annual charges to departments for fleet replacement.

Capital Fund

The *Proposed FY 2006-2010 Capital Improvements Program* (CIP) includes \$78.5 million for City capital projects and \$34.0 million for school capital projects. Adoption of the CIP is anticipated coincident with adoption of the annual budget. Major bond financed projects proposed for funding in FY 2006 include continued work on the addition to and renovation of E.C. Glass High School, Major Bridge Repairs, Street Overlay projects, Downtown/Riverfront improvements, Breezewood Drive improvements, and Old Graves Mill Road improvements. Proposed capital project appropriations total approximately \$21.7 million in FY 2006 for both the City and Schools.

Ideally, a portion of the Capital Improvement Program should be funded each year on a “pay-as-you-go” basis. Beginning in FY 2001, a portion of the fund balance above the targeted ten percent (10%) of General Fund Revenues was allocated to pay-as-you-go capital construction for smaller projects and/or projects that have a life of less than 20 years. General Fund savings in the Stadium Fund in FY 2004 of \$110,724 is allocated to pay-as-you-go financing in FY 2006. In addition, \$360,000 in historic tax credits for the Old Courthouse Renovation in FY 2005 are allocated for pay-as-you-go financing in FY 2006. And, as previously stated, an amount of \$160,000 from the Reserve for Court Facilities is being used to fund design of the Juvenile and Domestic Relations Court project in the Capital Improvement Program. The *Proposed FY 2006 Budget* provides \$2.2 million for pay-as-you-go projects.

A list of requested and proposed pay-as-you-go projects is provided on the following page.

**FY 2006 Requested and Proposed Pay-As-You-Go Capital Projects**

	Requested	Proposed	Increase/ (Decrease)
Buildings			
Major Building Repairs	\$ 856,136	\$ 856,136	\$ -
Old City Cemetery Parking Expansion	\$ 96,634	\$ 96,634	\$ -
Old Courthouse Exhibits	\$ 360,000	\$ 360,000	\$ -
Juvenile and Domestic Relations Court	\$ 160,000	\$ 160,000	\$ -
Total Buildings	\$ 1,472,770	\$ 1,472,770	\$ -
Transportation			
GLTC	\$ 62,702	\$ 62,702	
Street Overlay	\$ 4,115,000	\$ 254,840	\$ (3,797,458) ¹
Total Transportation	\$ 4,115,000	\$ 317,542	\$ (3,797,458)
Economic Development			
General Development Support	\$ 225,000	\$ 225,000	\$ -
Street and Utility Extensions	\$ 200,000	\$ 200,000	\$ -
Total Economic Development	\$ 425,000	\$ 425,000	\$ -
Parks and Recreation			
Athletic Field Improvements	\$ 80,352	\$ 80,352	\$ -
Parks Paving and Lighting/Athletic Court Paving	\$ 216,000	\$ 216,000	\$ -
Playground Replacement/Improvements	\$ 77,838	\$ 77,838	\$ -
Riverside Park Master Plan	\$ 43,200	\$ 43,200	\$ -
Total Parks and Recreation	\$ 417,390	\$ 417,390	\$ -
TOTAL GENERAL FUND PAY-AS-YOU-GO	\$ 6,430,160	\$ 2,632,702	\$ (3,797,458)

¹ An additional \$1.010 million is included in the project with funds from the City's highway maintenance allocation from the State for a total Street Repaving allocation in FY 2006 of \$1,264,840.

Airport Fund

The Lynchburg Regional Airport is budgeted as a separate fund to clearly delineate its financial operation and the support from the General Fund. Cost Center revenues and a General Fund subsidy of approximately \$535,283 cover total expenditures of \$2.3 million. FY 2006 operating expenditures are projected to increase by approximately \$65,000 from the current year. Additional costs related to contractual services, City administrative support, liability insurance and airport security are largely offset



by parking lot revenues, landing fees, rental car concessions, fuel flowage fees, and federal security reimbursements. The City's subsidy to the airport is projected to increase \$6,302. One significant change will be the privatization of Airport Rescue and Fire Fighting (ARFF) services replacing 3.33 employees of the Fire and EMS Department. Over time, this change is expected to reduce costs.

Water Fund

The City's water system can be characterized as having low rates and ample capacity, while being positioned for significant growth opportunities in its customer base. In addition to serving approximately 21,295 City accounts, water is sold by contract to the counties of Amherst, Bedford and Campbell and to several large industrial customers. The Water Fund operates as an enterprise fund and requires no subsidy from the General Fund. In fact, it makes a substantial contribution to the General Fund in the form of an indirect cost allocation.

The FY 2006 utility rate study proposes a 4% increase in the water rate. This year Utility staff performed much of the analysis in the study with resulting costs savings.

Water Fund total revenues are projected to increase by \$300,000, from \$9.6 million to \$9.9 million. Expenditures, including debt service, are projected to increase from \$8.7 million to \$9.0 million. The budget supports the hiring of a construction coordinator to manage capital projects in the Water Fund.

With the proposed rate increase, the unrestricted cash balance is projected to be forty-one percent (41%) of total fund expenditures for FY 2006 with a debt coverage ratio of 1.37, in compliance with City Council's policy to maintain a fund balance at forty percent (40%) of annual fund expenses and a debt coverage ratio of no less than 1.2.

Sewer Fund

The City's sewer system serves Lynchburg and portions of the surrounding counties. Although operated by the City, the wastewater treatment plant is a regional asset with capital and operating costs shared proportionally by the localities. The City also has contracts with several large industrial users. Like the Water Fund, the Sewer Fund is operated as an enterprise fund and requires no subsidy from the General Fund. It also provides an indirect cost allocation to the General Fund.

The *Proposed FY 2006 Budget* projects revenues of \$15.2 million, compared to expenditures of \$13.1 million, and includes a four percent (4%) rate increase as required by the Department of Environmental Quality (DEQ). The level of rate increase is intended to maintain the fund balance and debt coverage ratio at levels that ensure compliance with a Special Order between the City and the DEQ for the correction of Combined Sewer Overflows (CSO) and to provide for operating and debt service costs.

The special order with DEQ establishes a compliance schedule and project priorities for implementation of the CSO control plan. Although the City has spent over \$90 million on the CSO control program since 1993, the estimated cost to complete the remaining necessary work is over \$271 million. The compliance schedule does not contain fixed dates for implementing the CSO control plan,



but rather provides for implementation based on three criteria that reflect the limits of the City's financial capability. These criteria are:

1. The City is required to maintain rates so that the annual sewer bill for the average residential customer, using 7 hundred cubic feet (hcf) a month, equals or exceeds 1.25% of median household income (MHI).
2. The City is required to maintain a sewer operating debt coverage ratio within a range of 1.15 to 1.5.
3. The City is required to have reserve funds equal to no more than 25% of the prior year's budgeted operating expenditures.

With the rate increase recommended by the City's utility rate consultant, the unrestricted cash balance is projected to be 26% of fund expenses for FY 2006, with a debt coverage ratio of 1.34, therefore meeting the criteria defined by DEQ. Based on 2000 Census data, adjusted to July 1, 2004, the annual sewer bill for the average residential customer is estimated to be 1.14% of median household income.

Solid Waste Management Fund

The Solid Waste Management Fund is established as an enterprise fund. The fund assesses solid waste disposal costs through a tipping fee at the landfill, and a decal and tag system for residential collection. Collection costs are covered through a General Fund transfer. In addition, residents are charged a monthly fee of \$5, added to utility bills, to pay for certain "common good" services such as litter control, response to illegal dumping, recycling, and bulk and brush collection. The fund is in a strong financial condition as a result of actions taken by City Council in 2003.

FY 2006 revenues and expenditures are projected to be \$7.2 million.

In August 1999, City Council adopted financial policies that established a debt coverage ratio of no less than 1.2 and fund balance targets of 40% of annual fund expenses for enterprise funds. The *Proposed FY 2006 Budget* will meet the debt coverage ratio target. It is projected that the debt coverage ratio will be 1.76. The fund balance is projected to be seventy-one percent (71%) of expenses or \$5.1 million.

The Reserve for Landfill Construction is anticipated to increase by \$1.0 to \$2.2 million. The purpose of the reserve is to accumulate funds for the construction of the next landfill cell in 2008 and to avoid borrowing for this expense. With the FY 2006 contribution, the reserve will be fully-funded for the estimated cost of the next landfill cell. The long term goal is for landfill operations to be debt free by the time the useful space in the current location is filled up. Achieving debt free operations will allow the City to more freely explore alternatives to constructing another landfill.



Outstanding Issues

There are several outstanding issues that may impact budget deliberations.

- Revenue projections in the *Proposed FY 2006 Budget* are based on an analysis of actual revenues and trends up to January 1, 2005. Staff will re-examine revenues after April 1, 2005 and suggest appropriate adjustments.
- Legislation adopted by the General Assembly could add additional costs to localities. On the other hand, the adopted budget could provide additional funding. Staff will analyze how the actions of the General Assembly impact the proposed budget as information becomes available.
- Bankruptcy proceedings of U.S. Airways could significantly impact revenues to the Lynchburg Regional Airport if service was eliminated. The potential impact is estimated to be as much as \$35,000 per month in lost revenue.
- With the Old Courthouse Renovation complete, additional focus is needed on the future of the Museum System, including a permanent location for administrative offices and storage of exhibits currently housed at the Small Business Development Center. In discussing the future of the Museum System, an ideal scenario would include a location for a museum to house City artifacts (carriages, fire vehicles, etc.).
- Council asked that the issue of feral and free roaming cats be considered during budget deliberations. The proposal provided by the Lynchburg Humane Society to City Council in February included a request of one-time funding of \$20,000 to go towards a spay/neuter clinic; \$35,000 for a coordinator of a feral cat program (\$30,000 recurring personnel costs/\$5,000 equipment/office furniture), and \$2,000 annually for a focused education effort on feral and free-roaming cats.
- Street repaving requirements continue to outpace available resources. Over \$4 million a year is needed to bring the streets up to a sustainable standard. The proposed budget only provides approximately \$1.3 million.

Outlook

Fiscal challenges remain. Modest increases in revenues continue to be overwhelmed by increasing costs in a number of areas such as health coverage, fuel, steel, hardware and software maintenance and stormwater management. Although a recovering economy and tax increases enacted by the General Assembly have increased the state's ability to pay its fair share of the costs of state mandated, locally provided services, the Commonwealth still falls short of meeting its responsibilities in the areas of education, transportation, human services, and public safety. Furthermore, it continues to shift costs to the localities and to enact additional unfunded mandates. No matter how hard local governments try to extricate their agencies from State influences, they continue to be negatively impacted by State actions.

Now it appears that there will be additional challenges brought about by changes in the Federal budget. A number of programs that have been of benefit to cities such as the Community Development Block Grant and funding for law enforcement personnel are proposed for deep cuts. Federal budget proposals will also force additional costs for programs such as Medicare onto the state, and ultimately, to the localities.



FY 2007 will bring additional challenges. The Governmental Accounting Standards Board (GASB) has issued a new reporting requirement, GASB 45, which will require localities to recognize post-employment benefits as an expense. In addition, it is anticipated that a new funding formula will result in a significant impact in the revenue stream for Social Services.

Despite the many challenges facing older central cities such as Lynchburg, the outlook is hopeful. Downtown revitalization continues to gain momentum and the City remains the center for retail, dining, and cultural activities in the region. The City has actually seen some growth in population since the 2000 Census, primarily the result of the Wyndhurst development and other growth in the western part of the City. Inner city neighborhoods are also stabilizing and new housing opportunities are being developed downtown. The next year should see substantial work on the Bluffwalk hotel and restaurant complex and on City Market Lofts as well as a number of smaller private projects. City investment downtown will focus on the riverfront. By all appearances, the City is enjoying success in achieving its goal to improve the quality of life in Lynchburg.

Conclusion

The *Proposed FY 2006 Budget* is offered for City Council consideration, deliberation, amendment and adoption. Over the next several weeks, Council will have the opportunity to hear from and question the representatives of the various departments and agencies seeking funding in FY 2006. Work sessions will be held on Tuesday afternoons throughout the months of March and April. A public hearing on the proposed budget is scheduled for April 5, 2005, at 7:00 p.m., in Council Chambers. During Council's deliberations, staff is prepared to provide assistance and additional information as Council works towards budget adoption.

Copies of the *Proposed FY 2006 Budget* are available for public review at the main public library and the downtown branch as well as on the City's web site at www.lynchburgva.gov.

Acknowledgements

A number of City staff assisted in the development and production of the *Proposed FY 2006 Budget* and I would like to acknowledge their hard work. Once again Deputy City Manager Bonnie Svrcek provided outstanding leadership for the overall budget process. Director of Financial Services Michael Hill, Assistant Director of Financial Services Donna Witt, Michelle White and Cindy Speck in the Budget Office, Director of Human Resources Margaret Schmitt, and Human Resource Specialist Beth McDaniel provided valuable analysis, review, and logistical support in the development and production of the budget document. Financial Services staff Missy Cunningham, Amanda Smith, Lillian Lawrence, and Peggy Ferrell provided revenue projections, crunched numbers and balanced all of the City's funds. Leti Vance, Accountant III in Utilities provided invaluable help in preparing the Utilities section of this document. I am also particularly grateful for the extra effort contributed by a number of individuals who accepted the challenge of balancing their daily responsibilities with service as Budget Analysts. They are listed on the inside cover page.

Finally, I want to recognize the directors and staff of the various City departments who are committed to delivering desired services to the citizens of Lynchburg in the most cost effective, efficient



and equitable manner possible. In the end, it is the City employees that put the annual budget into action for the benefit of Lynchburg's residents and visitors. Every day, they respond directly or indirectly to the citizens of this community. They are the City government's greatest assets and they do an outstanding job.